RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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February 10, 1982 **LETTER 828**

Jan. 29, DJIA 871.10; PTI 1388; A-D Ratio –24.74
Feb. 5, DJIA 851.03; PTI 1378; A-D Ratio –24.99

THE PICTURE: Last week a subscriber asked me to name the single most important lesson I've learned in all my years of "Wall Street-ing." Without hesitation I answered, "The most important thing I've learned is to put my faith, my time and my energy into STUDYING THE ACTION OF THE MARKETS, as opposed to listening to the gossip, the theories, the analyses or even the predictions of so-called experts.

This is also the hardest thing to do. It takes years of experience and tough mental training to ignore the forecasts of experts, politicians, Presidents, authorities in the field--all in favor of listening to the message that is hammered out by the market day after day. So I've learned to believe in what famed Dow Theorist William Hamilton wrote almost 70 years ago: "When coming events cast their shadow before, those shadows fall on the New York Stock Exchange."

I keep a mental diary of the stock market, and usually the diary will provide some kind of on-going Wall Street story. The story is usually logical, clear and there for the reading--if we'll only bother to read it. Following is the current diary, in chronological order.

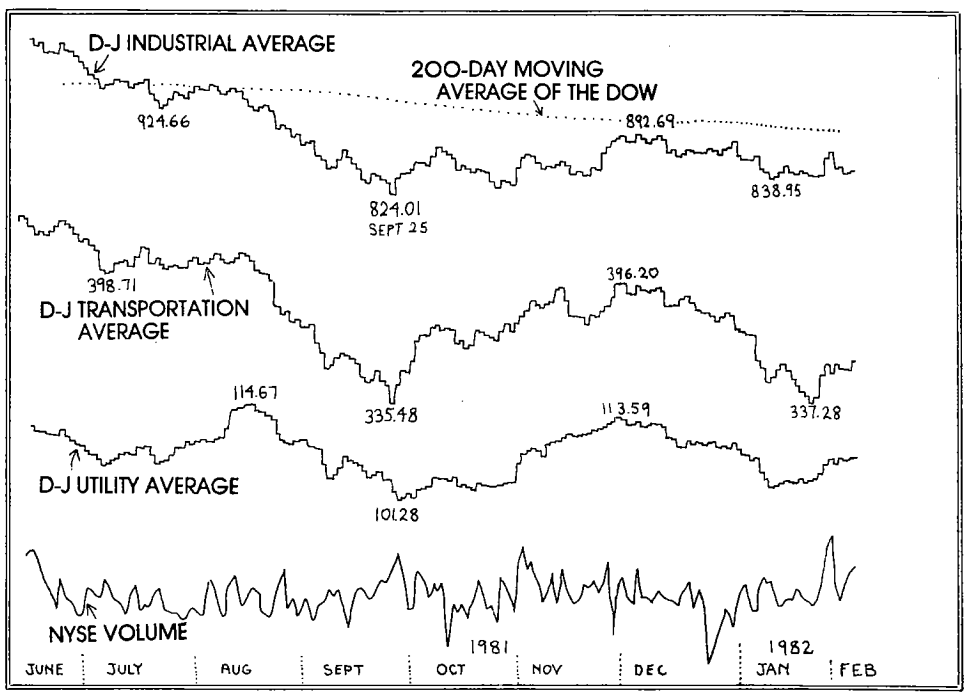
Jan. 5, 1981...D-J Utility Average records year's high of 117.81. That high has not since been bettered.
April 15, 1981...D-J Transportation Average records high of 446.59, a high not since bettered.
April 27, 1981...D-J Industrials record year's high of 1024.05, a high not since bettered.
June 23, 1981...PTI records a high of 1510, a high not since bettered.
July 2, 1981...D-J Industrial and Transport Averages give signal for a primary bear market under Dow Theory. The signal is widely ignored.
July 2, 1981...PTI cracks its trendline and provides a bear signal.

FRONT PAGE COMMENT: What's the recession doing for the budget? Well, lower oil profits are cutting into the Government's "windfall profits" taxes. Lower food prices are costing the Government more in price supports. Higher unemployment is costing the Government more in unemployment compensation. Lower individual income and lower corporate profits are going to cost billions in the Government tax take. Add to this the huge rise in military spending and what do we have?

The finances of this nation are going wacko, out of control, off into space. For the first three months of the new (1982) fiscal year the Federal deficit is $48 billion, up 73.5% from the same three months of last year! The WHOLE deficit for 1981 was $58 billion. The deficit for December ALONE was $19.4 billion. At this rate, the total Federal deficit for the 1982 fiscal year will be far over $100 billion. This is the gathering disaster that Mr. Reagan should be telling the American people about!

The end result of these deficit must and will be massive cuts in Federal spending. If these cuts are not brought about, the nation will (within a few years) be looking at decimated markets, hyper-DEFLATION and a vicious depression. I've said it before, and I'll repeat it now, we're seeing the power of compound interest IN REVERSE. The compounding debts of this nation are moving us towards a crisis of major proportions.

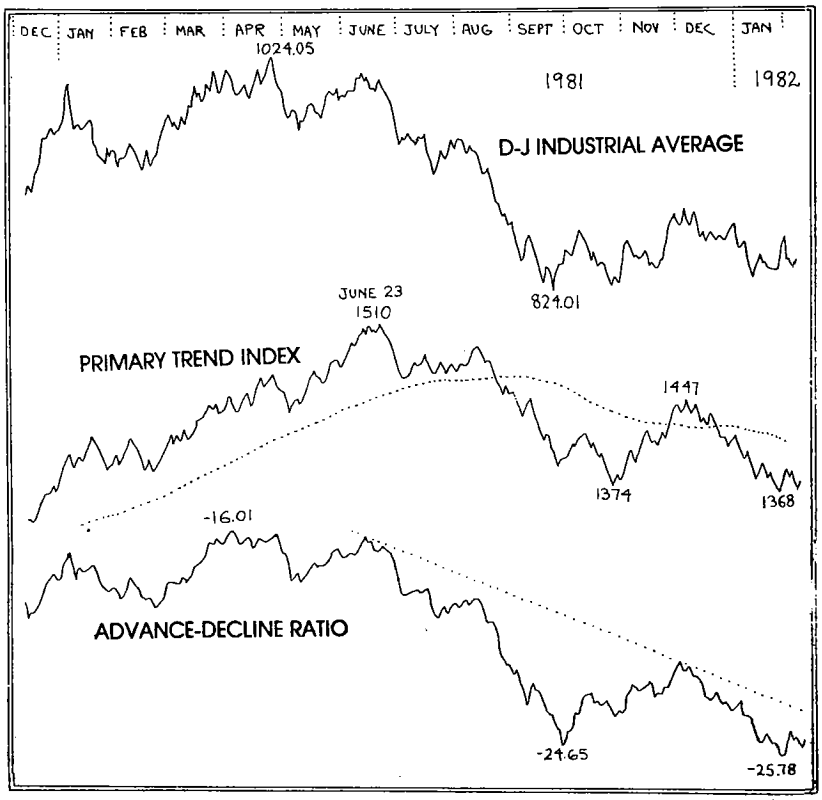
Sept. 29...Advance-decline ratio sinks to a 1982 low of minus 24.64.
Oct. 17...The negative volume index violates a 20-month rising trendline.
Dec. 14...The 5-day moving average of daily new lows surpasses the 5-day MA of daily new highs.
Jan 12, 1982 ...The A-D ratio breaks the Sept. 29 low and sinks to a new bear market low.
Jan. 26,...The PTI falls below the October 26 low of 1374, thus setting off a new bearish signal.



Why am I listing all these events? I list them because I want to demonstrate what it is to listen to the marketplace. I don't care what Volcker says, I don't care what Reagan says, I don't give a damn what Congress promises, I couldn't care less what Treasury Secretary Regan thinks. I watch the flow of events on the NYSE, and I accord full authority to those "messages."

When the flow of signals, data and information on the NYSE hesitates, halts and then reverses, that is when I will do the same. When the flow finally turns bullish again, then Richard Russell will be the biggest bull around.

The week ending January 22 represented the SEVENTH week of declining breadth for the NYSE. In the last 20 years there have been only four series of breadth declines exceeding seven weeks. In July-



September, 1966, breadth (i.e., the A-D ratio) declined for 9 consecutive weeks. During April-May, 1970, breadth declined for eight consecutive weeks. In January-March, 1973, breadth went down for eight consecutive weeks. And again in October-December, 1973, breadth went down for nine consecutive weeks.

The 1966 series ended the bear market of that year. The 1970 series was followed one month later by a bear market bottom. The two 1973 series were followed by bouncing, erratic rallies, and then by a resumption of the disastrous bear market.

My conclusion regarding the recent seven weeks of declining breadth (ending on the week of January 22, 1982) is that we could now experience a series of erratic rallies and declines, a disjointed series perhaps lasting a few weeks to a few months. But unless I received overwhelming evidence to the contrary, I expect the bear market to resume--in its own good time.

The fact is that seven consecutive weeks of declining breadth puts the market into a fairly over-sold position. The roaring rallies of January 28 and 29 (on volume of 66 and 73 million shares respectively) represented the market's response to that over-sold condition, but the story is not yet finished, and the odds heavily favor the bear doing more intensive downside work before the year is out.

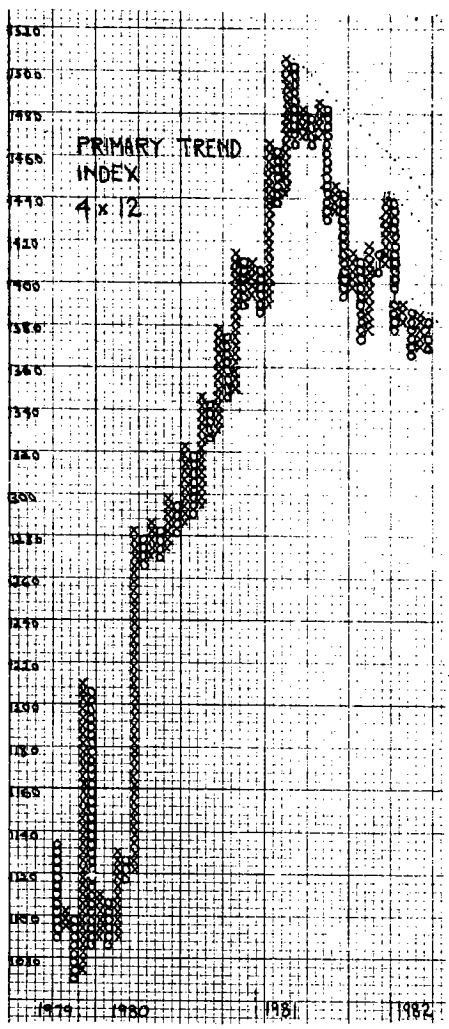
The current erratic market action jibes completely with what one "should" expect during the second phase of a bear market. In the last Letter (827) I wrote, "We are now in the second phase of the bear market, and the second phase is characterized by deceptions, false moves, costly break-outs and sudden collapses." And that's just about what's been happening.

Now turn to the page 1 chart of the Averages. Here we see the two Averages coming down from their early-December highs. On January 13 the Industrials struck a low of 838.95. The Averages then rallied, but on the next decline Transports broke to a new low of 337.28 (Jan. 26). Industrials did *not* confirm. That led to the recent rally.

I've said that the key to this market is the ability (or inability) of the Averages to hold above the September bear market lows of 824.01 (Industrials) and 335.48 (Transports). So far, the first test of those lows has been successful. Following any successful downside test, we expect a rally, and that is what has occurred. But unless the Averages can better the early-December highs (see chart), a second test of the September lows is to be expected.

The chart of the Primary Trend Index and the A-D Ratio provide another view of the market. The PTI, which is my own proprietary index, traces the build-up (or decline) in the technical understructure of the market. From a December 4 peak of 1447, the PTI broke below its 21-day moving average, then sank below its October 26 low of 1374. On January 27 the PTI recorded a new bear market low of 1368. The D-J Averages showed more strength than the PTI, and they refused to confirm the new PTI low. Consequently, the market rallied.

From this point on, the PTI should be particularly useful, since it will tell us how much strength the market is able to generate following the non-confirmation in the Averages. So far, the PTI action has not been impressive. But the IMPORTANT thing to watch for–is to see whether the PTI continues persistently along its declining path, and whether it continues to trace out its bearish series of descending peaks.

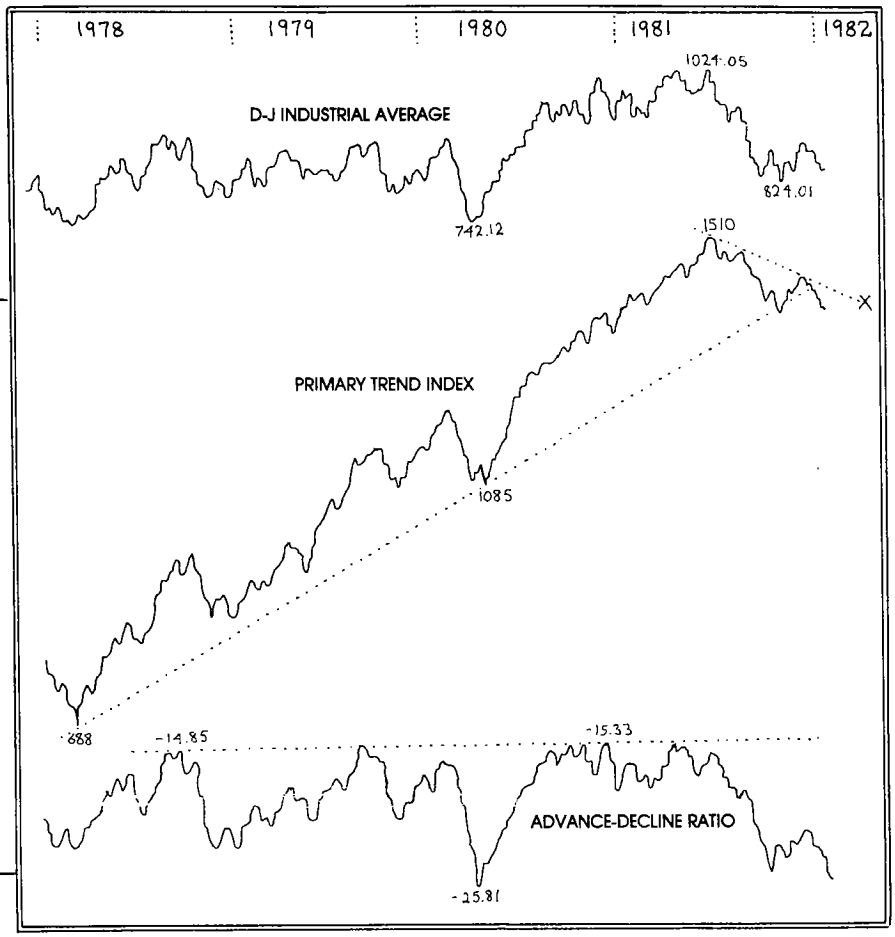


I'm including my 4x 12 point & figure chart of the PTI, and it is immediately apparent that a huge top has formed. My interpretation of this chart is that there is a large bearish potential that has still not been expressed by the PTI. This bearish potential could take the PTI down another 100 to 150 points (the PTI has already dropped from a June high of 1510 to a recent low of 1368). It is interesting to note that all the action since mid-1980 has been part of the top that we see on this chart.

The A-D Ratio at the bottom of the page 2 chart has pretty much paralleled the action of the PTI. The chart shows the A-D holding below a descending trendline, a trendline that has been in force since last June. On January 26 the A-D recorded a bear market low of minus 25.78. The rally since then (like the PTI rally) has been unimpressive. Note that the January 6 low was just a tiny fraction above the 1980 low of minus 25.81.

INVESTMENT POSITION: My Eastern informants tell me that the "smart boys" (mavens) in NYC are now loaded up (a good deal of it on big margin) with intermediate-term Treasury notes (maturities out to around 1984-87). If you want to put some of your money out 3-5 years, I don't think there is any huge risk as long as it's Treasury paper. But I want the BULK of my own money in 91-day T-bills, and I'll explain why in the "Interest Rate" section of this Letter.

As you may have noted, the bear still rules this box (and my thanks to NYC subscriber M. Elkins for this magnificent new bear).



PERSPECTIVE: On the chart above I show the action of three indicators for the period of 1978 to the present. What we see here is, in my opinion, one of the strangest market sequences in modern history, but it happened, and it's our job to make sense out of it.

The year 1978 started out with the Dow (Jan. 3) at 817.74. That's only 40 points from where the Dow is now-four years later. Yet the peaks in the Dow during the succeeding years did push higher with 1000.17 in 1980, and 1024.05 on April 27, 1981.

The A-D ratio (at the bottom of the chart) may be used as a proxy for ALL stocks on the NYSE. I have drawn a trendline through the tops of 1978, 1979, 1980 and 1981, and incredibly, the A-D topped out during each of these years in roughly the same area.

The big difference in the market action during the period of 1978 to the present is seen in the action of the Primary Trend Index. On a trend basis (but with sharp reactions during 1978 and 1980) the PTI remained bullish from 1978 to 1981. The overall rising trend in the PTI was telling us that despite political problems, despite deficits and inflation and a thousand other economic disturbances, the UNDERTONE of the market remained bullish.

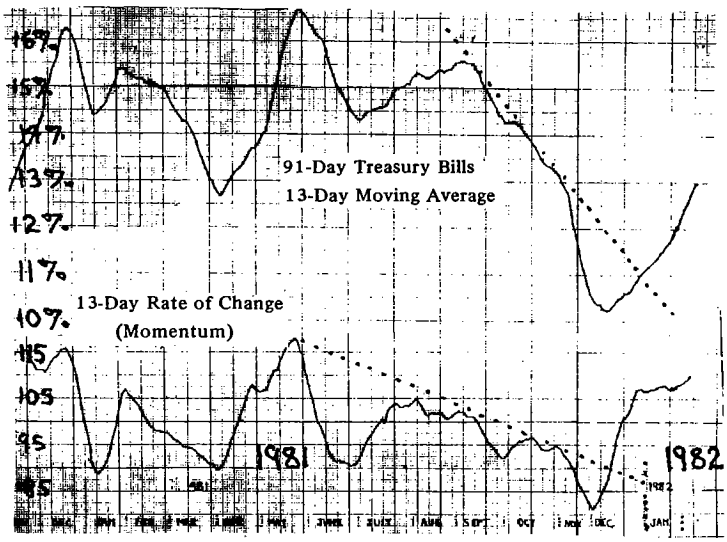
The PTI struck a record high of 1510 on June 23, 1981. Since then the trend of the PTI has been unmistakably down. In October the PTI turned down and made contact with its long-term trendline. A rally ensued, a rally which fizzled out in December. Then in January, 1982, the PTI resumed its slide, and this time the indicator broke decisively below the major 1978-81 trendline.

What now? The beauty of the PTI lies in its simplicity. I have drawn declining trendline X on the chart. As long as the PTI holds below that trendline, the trend of the market will be graded bearish. But if for any reason the PTI turns up and reverses the X trendline, the intermediate trend of the market will be graded bullish. It's as simple as that.

One observation is worth making about the action seen on this chart. During 1978 and 1981, with the PTI trending up, the A-D ratio was only able to move sideways, Now, with the PTI trending down, it would seem probable that we will see a major decline in the A-D ratio (and remember, the A-D is a proxy for the whole NYSE.)

INTEREST RATES: The conventional wisdom, the consensus opinion, the universal prediction--is that interest rates are fated to come down as the economy declines. EVERYBODY is thinking this, EVERYBODY knows this--except the market. In fact, Treasury Secretary Regan (who is rapidly becoming the Administration's official clown), makes a "lower rates around the corner" prediction almost daily via some press write-up or TV interview.

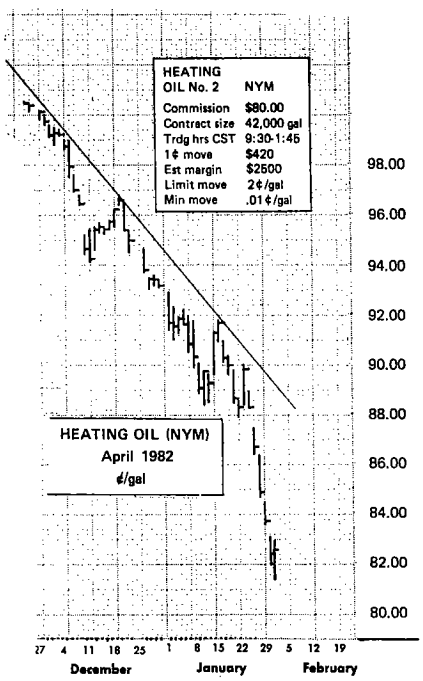
What's happening? Interest rates are staying high, very high, and the reason is that there is $5 trillion of debt in this country, and that debt has to be serviced. Furthermore, Washington is creating MORE debt daily. So the time-honored formula which states that interest rates come down with the economy isn't working today--not with this much debt overhanging the nation.



When things don't work according to official plans, a scapegoat is needed. Washington's scapegoat is the Fed. "The Fed's money policies are too erratic," screams the Treasury. But today interest rates are out of the hands of the Fed and into the realm of compounding mathematics.

My charts show the T-bills becoming very resilient to lower yields. Pushing those yields down is like trying to push a balloon under water. When markets won't go down, they rally. And an interest rate spike in first-half 1982 would not surprise me.

OIL: I don't imagine too many of my subscribers keep track of the commodity, heating oil, but heating oil is a proxy for world oil. This chart (courtesy of Dunn & Hargitt, Layfayette, Ind. 47902) shows the crash that has been occurring in the price of world oil. The high for this contract last year was roughly 1.10, so you can see what a disastrous drop this has been. The chart also shows something that no subscriber of mine should ever forget--and it is that THE MARKETS ARE BIGGER THAN ANYONE, bigger than the Arabs, bigger than Russia, bigger than the big US oil companies.



When markets want to go up or down, no force on earth is going to stop them. By the way, in their frantic effort to raise hard currencies, the Russians are now selling large quantities of oil as well as gold. On Feb. 5 the WSJ carried an article stating that Saudi Arabia was having trouble selling its new stepped-down quantity of 8.5 million barrels of oil per day.

TRUTH: Question: Russell, what's happening to Reaganomics? Answer: Reaganomics is unraveling, and it's doing so because the President never took the bull by the horns in the beginning, and because he never told the American people the whole story in the beginning. Now in all honesty, I'm not convinced that Reagan ever knew the full meaning of the deficits, the debt and the compounding effect of the debt. But in his campaign speeches Reagan sounded as if he knew what was going on, and he certainly mentioned the dangers of running budget deficits.

Question: Then where did Reagan go wrong? Answer: Reagan went wrong in thinking that he could put off balancing the budget until 1984--thereby easing the pain connected with budget cutting. Putting off the hard work was ridiculous. I knew it wouldn't work, and I stated just that in Letter after Letter. Secondly, Reagan's concept of raising military spending, lowering taxes and THEN trying to cut social and entitlement spending was financial insanity. It was doomed to failure before it started.

In his campaign speeches, Reagan should have told the American people that he was running on the basis of a balanced budget in 1982, massive cuts in Government spending, holding the line on taxes, and a drastic clean-up of inefficiencies in the military. Such a policy would also have brought in hard times, very hard times. But I felt the people would have accepted hard times for a balanced budget, an end to Government boondoggling, and an elimination of inflation.

The bitter truth is that Reagan never cut the actual amount of Government spending, he was only trying to cut the rate of spending. And Reagan isn't going to cut the actual amount of taxes, only the rate. But I insist that nothing will occur until (1) the actual amount of spending is cut (2) the actual amount of taxes is cut, and (3) the level of inflation is brought down to zero. In my opinion, NO amount of inflation is allowable. Inflation is thievery, the robbing of savings and earnings from every person who works for, or owns, dollars.

Question: All right, Russell, let's say you are Reagan. What would you do now about the current economic mess?

Answer: My answer is still the same. I'd tell the American people how bad the mess was. I'd tell them that the budget had to be balanced next year, I'd tell them that they were going to witness the biggest clean-out of departments and people in Washington that the nation has ever seen. And then I'd tell the people to prepare for hard times but no inflation at all (probably deflation). I'd tell the people that if they wanted anything else, I wasn't their man. A President during an emergency like this one should stand firm or get out. And oh yes, I would definitely declare a national economic emergency. I think this whole situation could be much better understood if it was placed within the context of a national emergency (and it is an emergency).

Question: Russell, no President could take that stand and stay in the White House.

Answer: I operate on the premise that the majority of people know the truth when they hear it. And that they will do what's best for themselves and their children even if such action means pain and deprivation. In my opinion, there's going to be no escaping the pain anyway, since ultimately this economic mess must express itself in pain. It's simply a question of the sytematic bankrupting of America via deficit spending and inflation--or going back to honest fundamentals. There's no middle course, no easy way out, no avoiding the pain--except the prevailing method of trying to pass it off to our children.

NOTES & QUOTES: A subscriber wrote last week questioning my statement in the last Letter to the effect that one-third to one-half of all Government spending is pure waste. In answer, I offer this piece from last week's US News & World Report. And this is what you and I pay taxes for!

> Thomas Sowell, a senior fellow at Stanford University's Hoover Institution, who is black, had something to say about this in a recent syndicated column. He wrote:
>
> "A few years ago, someone calculated how much it would cost to lift every man, woman and child in America out of poverty by simply giving them money. It was one third of what was being spent on poverty programs."
>
> Much of the tax money voted to help the poor never reaches them. Instead, Sowell points out, it trickles down to hordes of people paid to devise and run the welfare programs—"administrators, statisticians, consultants, economists, sociologists, think tanks, universities, social agencies and miscellaneous boondoggles."

* *

I continue to believe that Russia is in as much economic trouble as the West. This piece follows up the notes I included in the last report regarding Russian gold sales. Speaking of East-West bankruptcy, the world now spends half a trillion dollars on arms each year. This is the surest ticket I know to world insolvency. This is the single biggest ticket item in the world today--and it's insane. Mary Baker Eddy once wrote, "The only power evil has is the power to destroy itself." And that's what is worrying me!

The immense sale of gold the last few weeks by the Soviet Union has convinced the Reagan administration that Moscow is holing up for a long siege of reduced East-West trade, which would cut into hard currency earnings for the Soviet Union and its satellites.

Intelligence sources here report a gross gold sale by the Russians of 250 million ounces in 1981. Considering today's gold price of $375 an ounce — far below levels of last year — that adds up to a tidy sum.

The hard currency being paid for the Soviet gold has to be earmarked for cash-and-carry purchases of food, feed grains and industrial products, particularly for economically-prostrate and insolvent Poland.

Field Enterprises

* *

From our "I'm Getting Nauseous" Dept....Having made stupid and ill-advised loans to Poland, the banks are now afraid to declare Poland "in default." So who bails out the banks when Poland can't pay and Russia looks the other way? You guessed it, the slobs (taxpayers) like you and I pay! This clip from a William Safire column tells part of the story. Bless you, William, you're one guy who is capable of telling the truth!

The U.S. government last week decided, in secret, to pay $70 million a month to American banks unable to collect loans to Poland, despite rules of the Commodity Credit Corp. that require the debtor first be declared in default.

In plain words, the appeasement crowd at State (with the acquiescence of Treasury) not only recommended that we subvert the financial pressures on Poland agreed to at NATO two days before, but that we turn the charter of the CCC upside down to do it — and then in such a secret way as to deceive the U.S. public.

* *

Many of the US airlines are in trouble, and among other things they are in a cash bind. One airline is now offering trips to Hawaii for $100 in an effort to raise cash. This news clip gives you some idea of the extent of the trouble.

NEW YORK—Concern is mounting among lenders and suppliers to the nation's airlines that the rapidly deteriorating financial condition of half a dozen major carriers threatens to force one or more into bankruptcy, causing sizable writeoffs at banks and insurance companies and a painful contraction of orders for new aircraft.

"Do you realize," laments one New York banker, "that five major U.S. airlines right now are flirting with bankruptcy?" Adds another, "Instead of worrying about our Polish debt, you ought to be asking about our airline debt."

According to analysts, the domestic carriers fighting for survival are Braniff International, Continental Airlines, Pan American World Airways, Republic Airlines and Western Airlines. The chairman of a sixth, Frank Borman of Eastern Air Lines, has told employees that the carrier, which lost $39.2 million in the first nine months of 1981 and labors under a massive burden of debt, must earn a profit in 1982 or it will be cut drastically in size.

Continue to Help

Despite their problems, the airlines' creditors have thus far continued to support the carriers, in some cases by deferring payments on existing loans or extending emergency new loans. Ailing Braniff, with $161 million in principal

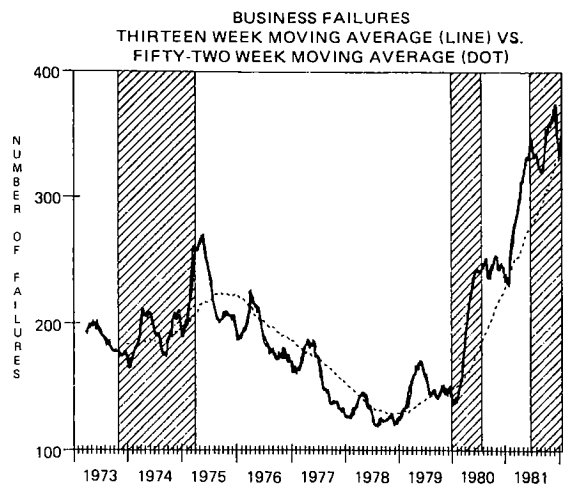
* *

In 1979 a new bankruptcy law went into effect. How did America react to the new law. They love it--as witness this article;

> NEW YORK (UPI) — Roughly 1 million people have declared personal bankruptcy in the two years under the 1978 Bankruptcy Act. Some 40 percent could have paid their bills. Instead they stuck consumers with a $1.6 billion annual tab.
>
> "A new class of bankruptcy debtor has emerged who uses bankruptcy as a form of financial planning," said Christine Edwards, government affairs representative for Sears Roebuck & Co. "Some run up credit knowing they are going to file for bankruptcy."
>
> Since the act went into effect Oct. 1, 1979, "Creditors are seeing bankruptcy petitions from persons who have continued high income, no history of credit problems, and who have no decrease in spending," Edwards said.
>
> The National Coalition for Bankruptcy Reform, a group of 285 banks and other lenders, along with the American Retail Federation and the National Retail Merchants Association have mounted an intensive campaign for enactment two bills currently in Congress to reform the act.

* * *

The accompanying chart gives you some idea of the severity of the current "recession." The chart (courtesy Manufacturers Hanover) traces the number of bankruptcies in the US, and the comparison of the current situation with the 1973-74 recession is dramatic. Bankruptcies today are moving far above those of 1973-74.



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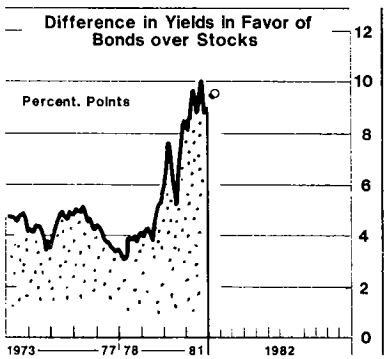
One of the problems this stock market faces is the tremendous yield advantage of bonds over stocks. This chart (courtesy of S&P's "The Outlook") shows that the yield spread between the S&P 500 Stock Index and the AA rated bonds is now 9.55% in favor of bonds. This differential is crucial, particularly for a pension fund that is subject only to deferred taxes. At 9.5%, money doubles in less than 8 years. Thus, a pension fund can double its money in eight years on the differential between the current income of bonds over stocks. When you look at it that way, you can see what a negative influence on stocks high bond yields are.



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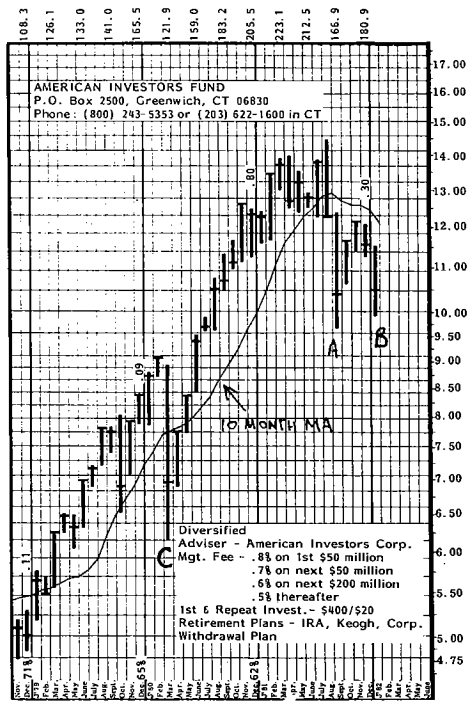
S. Jay Levy (Industry Reports, Box 26, Chappaqua, NY 10514) is Barron's favorite economist, and in truth, Levy probably has the best record of any economist in the US. Levy's latest forecast starts this way: "Industrial production, down 7% from the 1981 high, will fall for at least another six months. Retail sales will be increasingly affected by declining employment. The sharp drop in corporate profits will continue. Price will reflect diminishing profits and smaller rises in wages." The report ends as follows: "At present more than one-fourth of industry's capacity is idle and nearly one-tenth of the labor force is unemployed. Yet the economy will continue to decline."

LATE NOTES: With market breadth down for 7 consecutive weeks, many amateur traders and hopefuls have belatedly decided that "it must be a bear market." Consequently, they put out their shorts or puts. Which probably means that the market is ready to give the neophyte pessimists some sleepless nights. I get calls and letters every other day from people who want to know why I don't recommend shorts or puts. The reason I don't recommend them is because shorts and puts are pure speculative vehicles, and 4 out of 5 people invariably lose money when they try to speculate.

Furthermore, speculating for the decline is not like buying in a bull market (which should be a form of investing). It takes a special kind of trader to make money on the decline, and my experience has shown me that very, very few people are any good at the downside game.

Actually, owning cash in a bear market is a type of short position, since over any reasonable length of time you are able to buy an increasing amount of stock for the same amount of dollars. So my advice is to leave the puts and the shorts to the professional traders. Our position continues to be collecting the fat returns provided by the money instruments. I assure you that the 13.8% you're getting in T-bills is a lot more than the great majority of operators ever make in the stock market (on either the long or the short side).

This monthly chart shows the action of a typical, well-managed no-load fund. Note that at point B the price movement has fallen far below the 10-month moving average. This also occurred at points A and C, and each time there was an upward correction. It is almost axiomatic that any time a price falls substantially below a long-term moving average, then a correction is overdue. And that is where I think we are now. Note that the 10-month MA turned down in August, and the price has now held below the MA for six consecutive months (Feb. does not appear on this chart). As a rule, it takes six months or longer of negative price action to turn the public cautious to bearish. And since the public is now bearish, the market could be ready to interrupt its bear trend–temporarily. (Chart courtesy of Growth Fund Guide, Yreka, CA 96097).



GOLD: Last week everyone seemed to notice that "everybody else" was stone bearish on gold. And the truth is that gold has been holding like grim death above the 365-370 level. I'm neutral on gold now--not bullish, just neutral. The 5-week moving average for gold is 385, the 13-week MA is 396 and the 50-week MA is 442. Furthermore, my ratio of gold to common stocks still shows that the relative strength is on the side of common stocks. When gold finally turns bullish, this ratio will be in favor of gold.

Many experienced traders are telling me that gold looks interesting, and they think the turn is near--or even here. Maybe so, but I won't do anything until the 5-week MA has enough strength to cross ABOVE the 13-week MA. One thing moving averages do is make the market prove it's strength, and so far, spot gold is not even decisively above its 5-week MA (and I want the 5-week MA to better the 13-week MA). Nothing has been proved in gold yet....I'll wait.

NEXT MAILING: Feb. 24